Consolidated Interim Financial Statements of

# AROWAY ENERGY INC.

For the three and six months ended December 31, 2014 and 2013

**Notice for National Instrument 51-102**

The accompanying unaudited Consolidated Interim Financial Statements of the Company have been prepared by and are the responsibility of the Company's management. The Company's independent auditor has not performed a review of these Consolidated Interim Financial Statements in accordance with standards established by the Chartered Professional Accountants of Canada for a review of interim Consolidated Financial Statements by an entity's auditor.

# AROWAY ENERGY INC.

**(An Exploration Stage Company)**

Consolidated Interim Statements of Financial Position

(In Canadian Dollars)

(unaudited)

| | | December 31, 2014 | | June 30, 2014 |
|---|---|---|---|---|
| **Assets** | | | | |
| Current assets: | | | | |
| Cash | $ | 15,004 | $ | 240,973 |
| Trade and other receivables | | 455,252 | | 648,952 |
| Prepaid expenses | | 62,628 | | 14,140 |
| Available-for-sale investments | | – | | 20,000 |
| | | 532,884 | | 924,065 |
| Property and equipment (note 5) | | 4,200,235 | | 4,673,563 |
| Exploration and evaluation costs (note 6) | | 3,592,447 | | 3,307,480 |
| | $ | 8,325,566 | $ | 8,905,108 |
| **Liabilities and Shareholders' Equity** | | | | |
| Current liabilities: | | | | |
| Trade and other payables | $ | 7,789,923 | $ | 6,999,818 |
| Term loan (note 7) | | 540,580 | | 1,141,028 |
| Finance lease obligation (note 8) | | 539,346 | | 1,224,954 |
| Short term debt (note 9) | | 852,731 | | 805,599 |
| | | 9,722,580 | | 10,171,399 |
| Decommissioning liabilities (note 10) | | 653,775 | | 613,414 |
| Provisions (note 17) | | 197,500 | | 197,500 |
| | | 10,573,855 | | 10,982,313 |
| Shareholders' equity: | | | | |
| Share capital (note 11) | | 31,903,777 | | 31,903,777 |
| Contributed surplus | | 2,870,419 | | 2,506,586 |
| Warrants (note 11) | | – | | 363,833 |
| Deficit | | (37,022,485) | | (36,851,401) |
| | | (2,248,289) | | (2,077,205) |
| | $ | 8,325,566 | $ | 8,905,108 |

Nature and continuance of operations (note 1)

Contingencies (note 17)

The accompanying notes are an integral part of these consolidated interim financial statements.

# AROWAY ENERGY INC.

**(An Exploration Stage Company)**

Consolidated Interim Statements of Operations and Comprehensive Loss

For the three and six months ended December 31

(In Canadian Dollars)

(unaudited)

| | Three months ended December 31 | | Six months end December 31 | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Revenue: | | | | |
| Petroleum and natural gas sales | $ 1,645,712 | $ 2,803,048 | $ 3,957,922 | $ 5,643,001 |
| Royalties | (458,090) | (644,184) | (1,400,612) | (1,397,655) |
| | 1,187,622 | 2,158,864 | 2,557,310 | 4,245,346 |
| Expenses: | | | | |
| Production costs | 395,606 | 682,520 | 949,128 | 1,363,596 |
| Transportation costs | 40,296 | 82,272 | 78,673 | 174,426 |
| General and administrative | 291,162 | 324,135 | 539,482 | 686,991 |
| Share-based payments | – | – | – | 18,641 |
| Depletion and depreciation | 411,344 | 847,292 | 902,899 | 1,364,982 |
| | 1,138,408 | 1,936,219 | 2,470,182 | 3,608,636 |
| Interest income | 19 | 22 | 390 | 143 |
| Finance expense (note 8) | (97,667) | (31,603) | (258,602) | (79,039) |
| | (97,648) | (31,581) | (258,212) | (78,896) |
| (Loss) income from continuing operations | (48,434) | 191,064 | (171,084) | 557,814 |
| Income (loss) from discontinued operations (note 4) | – | 30,567 | – | (16,584) |
| Net (loss) income and comprehensive (loss) income for the period | $ (48,434) | $ 221,631 | $ (171,084) | $ 541,230 |

| | | | | |
|---|---|---|---|---|
| (Loss) income per share | | | | |
| Basic and diluted | | | | |
| Continuing operations | $ (0.00) | $ 0.00 | $ (0.00) | $ 0.01 |
| Discontinued operations | $ 0.00 | $ 0.00 | $ 0.00 | $ 0.00 |
| Total (loss) income per share | $ (0.00) | $ 0.00 | $ (0.00) | $ 0.01 |

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The accompanying notes are an integral part of these consolidated interim financial statements.

# AROWAY ENERGY INC.

**(An Exploration Stage Company)**

Consolidated Interim Statements of Changes in Shareholders' Equity

For the three and six months ended December 31
(In Canadian Dollars)
(unaudited)

| | Share capital | Contributed surplus | Warrants | Deficit | Total |
|---|---|---|---|---|---|
| Balance, June 30, 2013 | $ 31,903,777 | $ 2,385,624 | $ 422,740 | $ (32,694,583) | $ 2,017,558 |
| Expiry of warrants | – | 58,907 | (58,907) | – | – |
| Share based payments | – | 18,641 | – | – | 18,641 |
| Net income for the period | – | – | – | 541,230 | 541,230 |
| Balance, December 31, 2013 | 31,903,777 | 2,463,172 | 363,833 | (32,153,353) | 2,577,429 |
| Balance, June 30, 2014 | 31,903,777 | 2,506,586 | 363,833 | (36,851,401) | (2,077,205) |
| Expiry of warrants | – | 363,833 | (363,833) | – | – |
| Net loss for the period | – | – | – | (171,084) | (171,084) |
| Balance, December 31, 2014 | $ 31,903,777 | $ 2,870,419 | $ – | $ (37,022,485) | $ (2,248,289) |

The accompanying notes are an integral part of these consolidated interim financial statements.

# AROWAY ENERGY INC.

**(An Exploration Stage Company)**

Consolidated Interim Statements of Cash Flows

For the three and six months ended December 31
(In Canadian Dollars)
(unaudited)

| | Three months ended December 31 | | Six months end December 31 | |
|---|---|---|---|---|
| | **2014** | 2013 | **2014** | 2013 |
| Cash provided by (used in): | | | | |
| Operations: | | | | |
| Net (loss) income from continuing operations | $ (48,434) | $ 191,064 | $ (171,084) | $ 557,814 |
| Items not involving cash: | | | | |
| Depletion and depreciation | 411,344 | 878,616 | 902,899 | 1,425,729 |
| Share based payments | – | – | – | 18,641 |
| Amortization of deferred financing charges on term loan | 47,477 | – | 47,477 | – |
| Accretion on decommissioning liabilities | 4,324 | 6,050 | 7,635 | 12,064 |
| | 414,711 | 1,075,730 | 786,927 | 2,014,248 |
| Changes in non-cash working capital (note 13) | 248,527 | 1,817,792 | 935,317 | 1,425,329 |
| Cash flows provided by operations | 663,238 | 2,893,522 | 1,722,244 | 3,439,577 |
| Financing: | | | | |
| Repayments of credit facility | – | (1,200,000) | – | (2,150,000) |
| Proceeds on short-term debt | 20,000 | – | 47,132 | 50,000 |
| Repayments on finance lease | (428,266) | – | (733,085) | – |
| Repayments on term loan | (374,711) | – | (600,448) | – |
| Cash flows used in financing | (782,977) | (1,200,000) | (1,286,401) | (2,100,000) |
| Investing: | | | | |
| Expenditures on property and equipment | (153,448) | – | (289,079) | (1,092) |
| Expenditures on exploration and evaluation assets | 50,803 | (1,417,025) | (392,733) | (1,675,019) |
| Maturity of investment | 20,000 | – | 20,000 | – |
| Cash flows used in investing | (82,645) | (1,417,025) | (661,812) | (1,676,111) |
| Change in cash from continuing operations | (202,384) | 276,497 | (225,969) | (336,534) |
| Change in cash from discontinued operations | – | 30,567 | – | (16,584) |
| Change in cash | (202,384) | 307,064 | (225,969) | (353,118) |
| Cash, beginning of period | 217,388 | 55,496 | 240,973 | 715,678 |
| Cash, end of period | $ 15,004 | $ 362,560 | $ 15,004 | $ 362,560 |
| Cash interest paid | $ 64,009 | $ 30,132 | $ 152,800 | $ 76,105 |

The accompanying notes are an integral part of these consolidated interim financial statements.

## 1. Nature of Operations and Continuance of Operations

Aroway Energy Inc. (the "Company") was incorporated in British Columbia on March 27, 1980 under the name "Action Minerals Inc." On February 5, 2009, the Company changed its name to "Aroway Minerals Inc." On February 4, 2011, the Company changed its name to "Aroway Energy Inc." Its principal business activities include the exploration and development of oil and gas properties, and it is considered to be in the exploration stage. The Company's shares are publicly traded on the TSX Venture Exchange ("TSX"), the OTCQX in the United States and on the electronic trading system, XETRA, in Frankfurt, Germany. The registered office of the Company is Suite 1100, 888 Dunsmuir Street Vancouver BC, V6C 3K4.

The Company's consolidated unaudited interim financial statements as at December 31, 2014 have been prepared on a going concern basis, which contemplates the realization of assets and settlement of liabilities and commitments in the normal course of business. The Company had net losses of $48,436 and $171,086 for the three and six months ended December 31, 2014 (December 31, 2013 – net income of $221,631 and $541,230) and has a working capital deficiency of $9,189,696 at December 31, 2014 (June 30, 2014 – $9,247,334). The financial statements for the three and six months ended December 31, 2013 have been restated to present discontinued operations separate from continuing operations.

Current cash resources will not be sufficient to operate and to continue the exploration and development activities. Continuing operations are dependent upon the Company's ability to obtain additional financing which will be impacted by the significant decline in commodity prices, financial markets, economic conditions, and volatility in the debt and equity markets. The term loan matures in March 2015. If a new financing isn't closed prior to this date, the terms of this loan will need to be renegotiated. These factors have made, and could likely continue to make it challenging to obtain cost effective funding. There is no assurance that capital will be available and as such, there exists a material uncertainty that may cast significant doubt with respect to the Company's ability to continue as a going concern.

Management believes the use of the going concern assumption is appropriate based upon the assumption that the Company will attempt to complete further financings to ensure that sufficient cash resources exist to meet its ongoing obligations as they become due in the normal course of operations.

These financial statements have been prepared in accordance with generally accepted accounting principles applicable to a going concern, which assumes that the Company will be able to realize its assets and meet its obligations and continue its operations for the foreseeable future. Realization values may be substantially different from carrying values as shown and these financial statements do not reflect adjustments that would be necessary if the going concern assumption were not appropriate. If the going concern basis were not appropriate for these financial statements, then adjustments would be necessary in the carrying value of assets and liabilities, the reported revenues and expenses, and the balance sheet classifications used. These adjustments could be material.

## 2. Basis of Preparation

### a) Statement of Compliance

Aroway prepares its consolidated interim financial statements in accordance with International Financial Reporting Standards ("IFRS") as set out in Part 1 of the Handbook of the Canadian Institute of Chartered Accountants ("CICA Handbook"). These consolidated interim financial statements, are prepared in accordance with International Accounting Standard 34 *Interim Financial Reporting* ("IAS 34"). The consolidated financial statements do not include all the information required for annual consolidated financial statements. These interim consolidated financial statements should be read in conjunction with Aroway's audited consolidated financial statements for the years ended June 30, 2014 and 2013. Aroway's Board of Directors approved these consolidated interim financial statements on March 2, 2015.

Depletion and depreciation is presented on a separate line by their nature, while general and administrative expenses are presented on a functional basis.

### b) Functional and presentation currency

These financial statements have been presented in Canadian dollars which is the Company's functional currency.

### c) Use of judgment and estimates

The preparation of financial statements in conformity with IFRS requires management to make estimates and assumptions, and to use judgment that affects the reported amounts of assets and liabilities at the date of the financial statements and the reported amounts of revenues and expenses during the reporting period.

**Judgment**

<u>Exploration and evaluation assets and property and equipment</u>

In determining the amount of assets to recognize, the Company uses judgment to assess the likelihood that future economic benefit exists where the determination of technical feasibility and commercial viability occurs over a longer term project. The Company considers the results from drilling test wells, seismic, and, when appropriate, reserve assessments by a third party reserve engineer.

<u>Cash generating units</u>

A cash generating unit ("CGU") is defined as the smallest group of assets that generate cash inflows from continuing use that largely are independent of the cash inflows of other assets or groups thereof. The Company allocates costs to a CGU based on geographic location, shared infrastructure, and common geological and geophysical characteristics.

**Estimates**

Although these estimates are based on management's reasonable knowledge of the amount, event or action, actual results ultimately may differ from those estimates. Estimates and underlying assumptions are reviewed on an ongoing basis. Any change in estimate is recorded in the reporting period in which the estimate is revised. The critical accounting judgments, estimates and assumptions that have a significant risk of causing a material adjustment to the carrying amounts of assets and liabilities within the next financial year are discussed below.

**2. BASIS OF PRESENTATION** (continued)

**c) Use of judgment and estimates** (continued)

**Estimates** (continued)

Exploration & evaluation assets and property and equipment:

The carrying value of these assets is reviewed for impairment where there has been a trigger event (that is, an event which may have resulted in impairment) by assessing the recoverable amount. The recoverable amount is the higher of fair value less costs to sell and value in use which is determined by the present value of future cash flows. The calculation of estimated future cash flows would be based on estimates of gross reserves, production rates, oil and gas prices, future costs, discount rates, and other relevant assumptions for developed properties and the fair value for undeveloped land based on value per hectare from current land sales. These values are, therefore, subjective.

Decommissioning obligation

In accounting for the decommissioning obligation, the Company makes assumptions regarding the timing and the amount of reclamation and abandonment expenditures, inflation and discount rates, and possible changes in the legal and regulatory environment. This estimate is reviewed each reporting period.

Share based payments

In accounting for the fair value of stock options and warrants, the Company makes assumptions regarding share price volatility, risk free rates, forfeiture rates, and the expected life in order to determine the amount of associated expense to recognize.

Income taxes

Tax provisions are based on enacted or substantively enacted laws. Changes in those laws could affect amounts recognized in profit or loss both in the period of change, which would include any impact on cumulative provisions, and in future periods. Deferred tax assets (if any) are recognized only to the extent it is considered probable that those assets will be recoverable. This involves an assessment of when those deferred tax assets are likely to reverse and a judgment as to whether or not there will be sufficient taxable profits available to offset the tax assets when they do reverse. This requires assumptions regarding future profitability and is therefore inherently uncertain. To the extent assumptions regarding future profitability change, there can be an increase or decrease in the amounts recognized in respect of deferred tax assets as well as the amounts recognized in profit or loss in the period in which the change occurs.

## 3. Significant Accounting Policies

The significant accounting policies used in the preparation of these consolidated interim financial statements has been applied consistently for all periods presented and are unchanged from the policies disclosed in the notes to the consolidated financial statements for the year ended June 30, 2014 except as noted below.

The Company adopted the following new accounting policy:

IFRIC 21 *Levies* was released in May 2013 to provide guidance on the accounting for levies. IFRIC 21 indicates that entities are required to recognize a liability for a levy when the activity that triggers the payment of the levy, as defined by the legislation, occurs. The liability would be recognized progressively if the obligating event occurs over a period of time once the minimum threshold to trigger the level is reached. This guidance was effective for annual periods beginning on or after January 1, 2014.

There was no impact on the consolidated financial statements of the Company as a result of adopting this new accounting standard.

<u>Future pronouncements</u>

IFRS 9 *Financial Instruments* was originally issued in November 2009 then amended in October 2010 and in 2013. IFRS 9 is being released in three phases: 1) Accounting for financial assets and liabilities; 2) Impairment of financial assets; and 3) Hedge accounting. The first phase was released in November 2009 reducing the number of categories and measurement options for financial assets. Entities are required to select the measurement method based on both the entity's business model for managing financial assets and the contractual cash flow characteristics of the financial asset. Requirements for financial liabilities were released in October 2010. The amendments in 2013 include the temporary removal of the mandatory effective date for years beginning January 1, 2015 and the release of the third phase on hedge accounting. The effective date has been updated to annual periods beginning January 1, 2018. Hedge accounting remains optional. The new guidance is intended to improve the disclosure on risk management and provide more options of when to apply hedge accounting.

IFRS 11 *Joint Arrangements* was amended in May 2014 to include guidance on how to account for an acquisition of a joint interest that is constitutes a business under IFRS 3 *Business combinations*. This amendment is effective for annual periods beginning on or after January 1, 2016. Early adoption is permitted.

IFRS 15 *Revenue,* which was issued in May 2014, replaces IAS 18 *Revenue*, IAS 11 *Construction Contracts*, and other revenue related interpretations. This standard requires revenue recognition upon the transfer of goods or services when control is transferred to the purchaser and additional disclosure. This standard is effective for annual periods beginning on or after January 1, 2017. Early adoption is permitted.

The Company has not yet determined whether these standards will have any impact on their financial statements.

## 4. Discontinued Operations

On May 31, 2014, the Company disposed of its 50% working interest in the Worsley area to a third party for net proceeds of $390,000. The three and six months ended December 31, 2013 have been restated to present the results of operations in Worsley as discontinued operations on the consolidated statements of operations and comprehensive loss.

| | December 31, 2013 | |
|---|---|---|
| | Three months | Six Months |
| Petroleum and natural gas sales | $ 360,976 | $ 702,982 |
| Royalties | (75,259) | (147,019) |
| | 285,717 | 555,963 |
| Production costs | 219,247 | 502,670 |
| Depletion | 31,324 | 60,747 |
| Accretion expense | 4,579 | 9,130 |
| | 255,150 | 572,547 |
| Income (loss) from discontinued operations | $ 30,567 | $ (16,584) |

## 5. Property and Equipment

| | Oil and Gas Properties | Office Equipment | Total |
|---|---|---|---|
| **Cost** | | | |
| Balance, June 30, 2014 | $ 11,146,694 | $ 27,093 | $ 11,173,787 |
| Additions | 289,079 | – | 289,079 |
| Change in estimate for decommissioning liabilities | 32,726 | – | 32,726 |
| Transfer from exploration and evaluation (note 6) | 107,766 | – | 107,766 |
| Balance, December 31, 2014 | 11,576,265 | 27,093 | 11,603,358 |
| **Accumulated Depletion and Depreciation** | | | |
| Balance, June 30, 2014 | $ 6,479,403 | $ 20,821 | $ 6,500,224 |
| Depletion and depreciation | 901,959 | 940 | 902,899 |
| Balance, December 31, 2014 | 7,381,362 | 21,761 | 7,403,123 |
| **Carrying value** | | | |
| December 31, 2014 | $ 4,194,903 | $ 5,332 | $ 4,200,235 |
| June 30, 2014 | $ 4,667,291 | $ 6,272 | $ 4,673,563 |

## 5. Property and Equipment (continued)

Costs subject to depletion for the three and six months ended December 31, 2014 included estimated future development costs of $4.4 million for proved plus probable reserves (June 30, 2014 - $8.7 million).

Due to the significant decline in commodity prices, the Company completed an impairment test as at December 31, 2014 and determined that no impairment existed. The impairment is calculated as the difference between carrying value and fair value. Carrying value is cost less accumulated depletion and impairment losses. Value in use was based on a third party reserve report using discount rates of 10% on proved producing reserves, 12% on proved undeveloped and 15% on probable reserves. The following price assumptions were used in the reserve report:

| Year | Hardisty Heavy $/bbl | AECO spot $/MMbtu |
|---|---|---|
| 2015 | 50.00 | 3.50 |
| 2016 | 60.00 | 4.00 |
| 2017 | 65.00 | 4.40 |
| 2018 | 70.00 | 4.60 |
| 2019 | 75.00 | 4.90 |

Escalation rate thereafter – 2%

As at December 31, 2014, the Company completed a sensitivity analysis on the impairment test by utilizing higher discount rates in order to calculate the impact on impairment. It was determined that there would be no impact on impairment.

## 6. Exploration and Evaluation Assets

Exploration and evaluation assets include costs incurred on the Company's licenses in Alberta and Saskatchewan. Costs capitalized relate primarily to the acquisition of the licenses, seismic, and exploration costs. Costs are as follows:

| | | |
|---|---|---|
| **Cost** | | |
| Balance, June 30, 2014 | $ | 3,307,480 |
| Additions | | 392,733 |
| Transfer to property and equipment (note 5) | | (107,766) |
| Balance, December 31, 2014 | $ | 3,592,447 |

Due to the significant decline in prices, the Company determined that indicators of impairment existed as at December 31, 2014. The impairment is calculated as the difference between carrying value and fair value. Carrying value is cost less accumulated impairment losses. Fair value was based on the value of undeveloped land using prices from recent public land sales and management estimate of the value of a recently shot seismic program.

### 7. Term Loan

In April 2014, a term loan in the amount of $1,600,000 was advanced, with a stated interest rate of 16% per annum, maturing on March 31, 2015. This loan is repayable with principal payments of $133,000 plus interest on a monthly basis. As at December 31, 2014, the obligation outstanding under this loan was $540,581 (June 30, 2014 - $1,141,028). Deferred financing fees of $11,496 related to the loan (June 30, 2014 - $58,973) are recorded on the statement of financial position.

The Company has granted security, which contains a $25,000,000 debenture with a first floating charge over all assets of the Company with an undertaking to provide fixed charges on the Company's properties and a general assignment of all amounts receivable by the Company.

### 8. Finance Lease

In February 2014, the Company entered in to a finance lease whereby the Company would lease a production facility over a period of eleven months. Under the terms of the lease, the Company is required to make fixed monthly payments of $184,450 for nine months. Prior to the payout, the Company has an ownership interest of 1% in the facility. After these nine payments are made, the Company will have an ownership interest of 95% in the facility. If the Company fails to make the required payments, the lessors may in their sole discretion immediately take and sell oil produced by the Company with such oil to be valued equal to outstanding amounts. Once the total payout costs have been satisfied, the Company is to pay to the minority owner an amount of $6,250 each month for 12 months, at which time the payments then cease. The interest rate implicit in this lease is 16% per annum.

As at December 31, 2014, the obligation outstanding under this lease was $539,346 (June 30, 2014 - $1,224,954). The leased asset is being depleted using the unit of production method.

### 9. Short-Term Debt

The Company entered into short-term demand loans with third parties for principal amounts totaling $852,731 (June 30, 2014 - $805,599), which bear interest at 1.00% (June 30, 2014 – 1.00%) per month, are unsecured and are payable on demand. As at December 31, 2014, the Company had a balance of $158,752 (June 30, 2014 – $108,517) and $852,730 (June 30, 2014 - $805,599) related to interest payable and principal outstanding on these loans respectively.

### 10. Decommissioning obligation

The following table presents the reconciliation of the carrying amount of the obligations associated with the reclamation and abandonment of the Company's exploration and evaluation assets and property and equipment:

| | | |
|---|---|---|
| Balance, June 30, 2014 | $ | 613,414 |
| Change in estimate | | 32,726 |
| Accretion | | 7,635 |
| Balance, December 31, 2014 | $ | 653,775 |

**10. Decommissioning obligation** (continued)

The change in estimate is related to the decrease in discount rates.

As at December 31, 2014, the following significant assumptions were used to estimate the decommissioning obligation:

| | | |
|---|---|---|
| Undiscounted cash flows | $ | 923,479 |
| Risk free rate | | 2.33% |
| Inflation rate | | 1.50% |
| Weighted average expected timing of cash flows | | 15 years |

**11. Share Capital**

(a) Issued:

Share capital:

| | Number | | Amount |
|---|---|---|---|
| Common shares | | | |
| Balance, December 31, 2014 and June 30, 2014 | 61,769,160 | $ | 31,903,777 |

(b) Warrants:

| | Number | | Amount |
|---|---|---|---|
| Balance, June 30, 2014 | 4,584,741 | $ | 363,833 |
| Expiry of warrants | (4,584,741) | | (363,833) |
| Balance, December 31, 2014 | – | $ | – |

During the year ended June 30, 2014, the Company had received TSX Venture Approval to re-price and extend the term of 4,584,741 share purchase warrants (the "Warrants") originally granted in November 2012. The original expiry date of December 4, 2013 was extended to June 12, 2014. The Warrants consisted of 3,212,741 Warrants with an exercise price of $0.65 per Warrant and 1,372,000 Warrants with an exercise price of $0.60 per Warrant, which were issued in connection with the Company's private placement that closed in December 2012. On June 9, 2014, the Company again modified the term of the Warrants and re-priced the Warrants with the new exercise price for each full Warrant set at $0.30. The foregoing Warrants expired on December 12, 2014.

**11. Share Capital** (continued)

(c) Stock Options

Stock options issued and outstanding are as follows

| | Number | Weighted average exercise price |
|---|---|---|
| December 31, 2014 and June 30, 2014 | 4,182,000 | $ 0.57 |

Details of the stock options outstanding at December 31, 2014 are as follows:

| Range of Exercise Prices | Number of options outstanding and exercisable | Weighted Average Remaining Life |
|---|---|---|
| $0.30 to $0.39 | 1,072,000 | 1.56 |
| $0.40 to $0.49 | 530,000 | 1.62 |
| $0.50 to $0.59 | 350,000 | 1.60 |
| $0.70 to $0.79 | 2,230,000 | 2.00 |
| | 4,182,000 | 1.80 |

(d) Income (loss) per share

The weighted average number of shares outstanding for purposes of calculating basic and diluted income (loss) per share for the three and six months ended December 31, 2014 was 61,769,160 and 61,769,160 (December 31, 2013 – 61,769,160 and 61,769,160). For the three and six months ended December 31, 2014, diluted loss per common share did not include warrants and options as the effect would be anti-dilutive.

**12. Finance Expense**

Finance expense consists of the following:

| | Three months ended December 31 | | Six months ended December 31 | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Interest expense - loans | $ 60,593 | $ 30,133 | $ 132,378 | $ 76,106 |
| Interest expense - lease | 11,405 | – | 77,720 | – |
| Amortization of deferred financing fees | 19,344 | – | 47,477 | – |
| Accretion on decommissioning liabilities | 4,324 | 1,470 | 7,635 | 2,933 |
| Other | 2,001 | – | (6,608) | – |
| | $ 97,667 | $ 31,603 | $ 258,602 | $ 79,039 |

## 13. Changes in non-cash working capital

| | Three months ended December 31 | | Six months ended December 31 | |
|---|---|---|---|---|
| | 2014 | 2013 | 2014 | 2013 |
| Operating activities: | | | | |
| Amounts receivable | $ 199,600 | $ (15,644) | $ 193,700 | $ (332,422) |
| Prepaid expenses | (46,447) | (10,801) | (48,488) | 30,691 |
| Accounts payable | 95,374 | 1,844,237 | 790,105 | 1,727,060 |
| | $ 248,527 | $ 1,817,792 | $ 935,317 | $ 1,425,329 |

## 14. Related Party Transactions

During the three and six months ended December 31, 2014, the Company recognized $101,877 and $169,377 for accounting, legal and management services in general and administrative expense (December 30, 2013 - $45,000 and $90,000) to directors, officers, former officers or companies controlled by directors or officers.

As at December 31, 2014, amounts due to related parties of $406,326 (June 30, 2014 - $324,178) are included in accounts payable and accrued liabilities. The amounts are non-interest bearing, unsecured and have no fixed terms of repayment.

These transactions are in the normal course of operations and are measured at the exchange amount established and agreed to by the related parties.

## 15. Financial instruments and Financial Risk Management

The Company's risk management policies are established to identify and analyze the risks faced by the Company, to set appropriate risk limits and controls, and to monitor risks and adherence to limits. Risk management policies and systems are reviewed regularly to reflect changes in market conditions and the Company's activities. The Company, through its training and management standards and procedures, aims to develop a disciplined and constructive control environment, in which all employees understand their roles and obligations.

The Company classifies fair value of its financial instruments according to the following hierarchy on the amount of observable inputs used to value the instruments.

Level I – Quoted prices are available in active markets for identical assets or liabilities at the reporting date. Active markets are those in which transactions occur in sufficient frequency and volume to provide pricing information on a consistent basis.

Level II – Pricing inputs used are other than prices in active markets included in Level I. Fair values in Level II are determined by using quoted market prices in active markets and adjusted for factors specific to the asset or liability. Level II valuations are based on inputs, including quoted forward prices for commodities and interest rates, time value, volatility factors and broker quotations, which can be substantially observed or corroborated in the market place for over-the-counter derivatives.

**15. Financial instruments and Financial Risk Management** (continued)

Level III – Fair values are determined using inputs for the asset or liability that are not readily observable or are unavailable. In these instances, internal methodologies are used to determine fair value with inputs based upon historical data, forward pricing curves, time value of money, and market risk including counterparty default.

(a) Credit Risk

Credit risk arises from the possibility that a counterparty to which the Company provides goods or services is unable or unwilling to fulfill their obligations. The extent of the risk depends on the credit quality of the counterparty to which the Company provides goods or service.

The Company's primary exposure to credit risk is the carrying value of cash of $15,004 as at December 31, 2014 (June 30, 2014 - $240,973) and trade and other receivables of $455,252 (June 30, 2014 - $648,952) predominantly with one marketer of the related properties. As the Company's policy is to limit cash holdings and near cash investments to instruments issued by major Canadian banks, or investments of equivalent or better quality, the credit risk is considered by management to be negligible. Management believes that the credit risk concentration with respect to its receivables is minimal.

(b) Liquidity Risk

Liquidity risk is the risk that the Company will not be able to meet its financial obligations as they fall due. The Company's approach to managing liquidity is through regular monitoring of cash requirements by preparing short-term and long-term cash flow analysis. Any short fall in expected cash requirements is mitigated by the issuance of equity instruments. Reference is also made to note 1 of these financial statements.

(c) Market risk

Market risk is the risk that the fair value or future cash flows of a financial instrument will fluctuate because of changes in market prices. Market price risk is comprised of three types of market price changes: foreign currency exchange rates, interest rates and commodity prices.

(i) Foreign currency exchange risk

The Company is not exposed to foreign currency exchange rate fluctuations.

(ii) Interest rate risk

Interest rate risk is the risk of change in the borrowing rates of the Company. Changes in the market interest rates affect future cash flows related to the credit facility. A 1% change in the prime interest rate would not have a significant impact on interest expense and net loss of the Company, assuming that all other variables remained constant. As at December 31, 2014 and June 30, 2014, the Company's debt is all fixed interest rates on their financial liabilities.

(iii) Commodity price risk

Commodity price risk is the risk of price volatility of commodity prices, such as oil, natural gas and natural gas liquids. The Company does not hedge its exposure to commodity price volatility.

## 16. Capital Management

The Company manages its capital in a manner consistent with the risk characteristics of the assets it holds. All financing, including equity and debt, are analyzed by management and approved by the Board of Directors. The Company's objectives when managing capital are: (a) to safeguard the Company's ability to continue as a going concern and provide returns for shareholders; and (b) to facilitate the acquisition or development of oil and gas projects in Canada consistent with the growth strategy of the Company. The Company manages capital through its detailed review and performance of due diligence on all potential acquisitions, preparing short-term and long-term cash flow analysis to ensure an adequate amount of liquidity and monthly review of financial results. The following table represents the net capital of the Company:

| | | December 31, 2014 | | June 30, 2014 |
|---|---|---|---|---|
| Term loans | $ | 540,580 | $ | 1,141,028 |
| Short-term debt | | 852,731 | | 805,599 |
| Finance lease obligation | | 539,346 | | 1,224,954 |
| Less: Cash | | (15,004) | | (240,973) |
| Net debt net of cash | $ | 1,917,653 | $ | 2,930,608 |
| Shareholders' equity (deficiency) | | (2,248,291) | | (2,077,205) |

The Company does not have any externally imposed requirement on its capital. There have been no changes to the approach to capital management in the six months ended December 31, 2014.

## 17. Contingencies

The Company is involved in various legal claims and actions arising in the course of the Company's discontinued operations related to the Worsley property. Although the outcome of these claims cannot be predicted with certainty, the Company recorded a provision of $197,500 related to these claims where a loss is probable and the amount can be reliably estimated in the year ended June 30, 2014. The Company is also involved in various legal claims and actions with respect to its current operations. Although the outcome of these claims cannot be predicted with certainty, the Company has not recorded a provision related to current claims.